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SUBJECT: Citibank Skeptical of Government Lending Plans

¶1. (SBU) SUMMARY. Citibank El Salvador's head expressed skepticism over Government of El Salvador proposals to increase lending through secured transactions, government guarantees, and a government development bank. In Citibank's view, cash-flow-based lending is the most effective method, as secured transactions take too long to collect on collateral and rely on El Salvador's erratic court system. Similarly, government guarantees might help in a few borderline cases but would not have a big effect, while a national development bank lacks a coherent lending strategy. Reforms like improving collateral-based lending would help further modernize El Salvador's financial system, but issues like the court system will also need to be addressed to broadly expand access to credit. While Citibank is the most conservative major bank, its views are shared by the other major players in the sector. END SUMMARY.

¶2. (SBU) According to Citibank El Salvador Executive Director Alvaro Jaramillo, the GOES has proposed three main ideas to increase lending and expand access to credit: increased use of secured transactions, a government-backed guarantee fund, and the creation of a government-run national development bank. The latter two are new projects, while the former involves reforms and expansion of existing laws. El Salvador does allow moveable collateral-based lending, but a previous attempt at reform by the Flores Administration (1999-2004), working with USAID, was not fully implemented. The Funes Administration has revived these efforts, also with USAID assistance.

¶3. (SBU) In Jaramillo's view, secured transaction reform would not increase bank lending. Under the current system, he said, it takes a minimum of 3.5-4 years to collect on the collateral in event of default, and by that time the collateral equipment is in such bad shape it is of little value. Citibank's only major collateral-based lending is for coffee production, using the crop as a guarantee, but Citibank puts extra checks on the process like requiring the use of bonded warehouses for the final crop. Even if the laws were reformed to make collection easier, Jaramillo said, the banks still lack faith in the court system to fairly enforce those laws. Jaramillo predicted that the international banks would continue to use cash flow-based lending for the vast majority of their portfolios.

¶4. (SBU) Government-guaranteed lending, according to Jaramillo, might make a difference in marginal cases, with borderline cash flow projections. Jaramillo said the GOES proposal would guarantee 30-40% of a loan, not its full value. The GOES would use the state-owned second tier Multi-sector Investment Bank (BMI) to provide the guarantees, which the banks consider sovereign guarantees for their risk portfolios.

¶5. (SBU) The GOES's most ambitious proposal would convert BMI into a first-tier national development bank, modeled after Brazil's national development bank. In Jaramillo's opinion, however, the GOES proposal lacks one fundamental component - a lending strategy tied to clear development goals. Brazil, he said, used its national development bank to build up key sectors like biofuels in which it saw clear long-term potential. The GOES, on the other hand, had not shared any kind of strategy with either the banks or the Brazilian banking consultant with whom Jaramillo had spoken. Jaramillo speculated that this idea may be driven more by the desire to have a viable national bank that would be more responsive to GOES program goals or incentives. Jaramillo added that in a recent bank presidents' meeting, Minister of Finance Carlos Caceres said Brazilian President "Lula" de Silva had been advising President Funes that the internationalization of the Salvadoran banking sector was a mistake, since the banks did not have El Salvador's interests at heart.

¶6. (SBU) Overall, Jaramillo expressed pessimism over El Salvador's economic prospects. He noted that Citibank El Salvador lost about $18 million in 2009 (NOTE: Jaramillo subsequently told Commercial Counselor Citibank El Salvador's losses totaled $70 million, including write-offs of bad loans from the local banks they had acquired. END NOTE) , but he added that the bank was still lending where it saw prospects. Fundamentally, Jaramillo said, increased consumer demand for businesses' products and services is needed to really spur lending. Neither he nor Banco Agricola's

(BanColombia's) Colombian Chairman of the Board saw signs of economic recovery, he said. In the longer term, the real question for the country was where it would find its competitive advantage, he added, and he did not have an answer.

¶7. (SBU) COMMENT: Financial inclusion and extending the benefits of trade to non-traditional beneficiaries are policy priorities for the Funes government, and the GOES has expressed interest in working on these issues together with the United States. Reforms like improving collateral-based lending would be an important step in further modernizing El Salvador's financial system. Citibank's frank assessment of the immediate effects on lending, however, demonstrate that secured transaction reforms alone are not enough. Other issues, like El Salvador's inconsistent judicial system, will also have to be addressed in order to ultimately expand access to credit.
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